

OPEN MEETING AGENDA ITEM
EXCEPTION

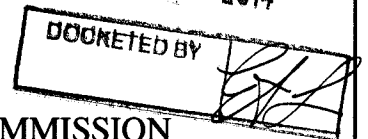


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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
ROBERT L. BURNS
SUSAN BITTER SMITH

ORIGINAL

IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR A HEARING TO
DETERMINE THE FAIR VALUE OF THE
UTILITY PROPERTY OF THE
COMPANY FOR RATEMAKING
PURPOSES, TO FIX A JUST AND
REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP
SUCH RETURN.

DOCKET NO. E-01345A-11-0224

**EXCEPTIONS OF ARIZONA PUBLIC
SERVICE COMPANY TO
RECOMMENDED OPINION AND
ORDER**

Pursuant to A.A.C. R14-3-110(B), Arizona Public Service Company ("APS" or "Company") hereby submits its Exceptions to the Recommended Opinion and Order ("ROO") filed on December 5, 2014 in the above-captioned matter. But before going further, the Company would like to commend the Presiding Administrative Law Judge for her skillful handling of a difficult hearing and her fair and unbiased treatment of the parties during the course of that hearing. The differences that APS expresses in its Exceptions

1 concerning the findings and conclusions of the ROO ought not to obscure these important
2 facts.

3 4 **I. INTRODUCTION.**

5 The Arizona Corporation Commission ("Commission") is by now quite familiar with
6 the long saga that has been Four Corners. The Commission authorized APS to acquire
7 Southern California Edison Company's ("SCE") share of Four Corners Units 4 and 5
8 ("Four Corners Acquisition") in Decision No. 73130 (April 24, 2012). One month later, the
9 Commission approved the 2012 Settlement of the Company's 2011 general rate case in
10 Decision No. 73183 (May 24, 2012). Section X of the 2012 Settlement held the rate case
11 open to allow APS to incorporate into rates a Four Corners Rate Rider reflecting the Four
12 Corners Acquisition. On December 30, 2013, the Company filed the instant request. Using
13 data through April 30, 2014, the Four Corners Rate Rider would be \$65.44 million, or
14 2.33%. (See Rebuttal Testimony of Elizabeth Blankenship, APS Exhibit 11, at Schedule
15 EAB-4.)

16 There were only three contested issues in this proceeding: (1) Fair Value Rate of
17 Return ("FVROR"); (2) the prudence of the Four Corners Acquisition; and (3) the
18 application of the Four Corners Rate Rider to APS customers taking service under Rate
19 Rider AG-1. APS does not contest and indeed supports the ROO's resolution of the latter
20 two issues.¹

21 22 **II. FAIR VALUE RATE OF RETURN ON THE FOUR CORNERS 23 ACQUISITION**

24 **A. It is not Possible to Keep all Elements of the 2012 Settlement 25 Constant and Still Allow APS the Opportunity to Recover "the 26 Rate Base and Expense Effects Associated with the Acquisition 27 of SCE's Share of Units 4 and 5 ..." [Decision No. 73183, 28 Exhibit A, Paragraph 10.3]**

¹ The Schools Association did attempt to inject an issue that was not litigated during the overwhelming majority of the hearing concerning the legality of the Four Corners Rate Rider. This issue was never raised by the Schools Association in conjunction with Decision No. 73183, which authorized the Four Corners Rate Rider, and was rightly rejected by the ROO. See ROO at page 9, line 21 through page 10, line 8.

1 At page 31, lines 14 and 15, the ROO states: "Nothing in the Settlement Agreement
2 or in Decision No. 73183 authorizes the FVROR to change." While a change in certain
3 figures was not expressly spelled out in the Settlement Agreement, it is clear that the Four
4 Corners Acquisition could not be incorporated into APS rates without modifying certain
5 related aspects of the 2012 Settlement and Decision No. 73183. Indeed, the necessity of
6 modifying certain numerical components was the reason it was also necessary to keep the
7 rate case docket open in the first place. For example, Paragraph 3.1 of the 2012 Settlement
8 proposes a specific non-fuel revenue increase for APS, as does Finding of Fact No. 40 in
9 Decision No. 73183 – a figure that must necessarily be further increased to reflect the "rate
10 base and expense effects associated with the acquisition of SCE's share of Units 4 and 5."
11 Yet the Settlement Agreement and Decision No. 73183 are silent about both of those
12 changes to specific findings of the Settlement Agreement. Again, Paragraph 3.2 of the 2012
13 Settlement as well as Finding of Fact No. 35 in Decision No. 73183 set forth a specific fair
14 value, and in the case of the latter, an original cost rate base. Both of these numbers also
15 necessarily change when the Four Corners Acquisition is included in APS rates, again
16 without there being any mention of or specific authorization for such changes in either the
17 Settlement Agreement itself or Decision No. 73183. And although not expressly delineated
18 in the 2012 Settlement, implicit in the 2012 Settlement revenue requirement were
19 allowances for property taxes, depreciation, etc., which must now necessarily increase to
20 reflect the costs of the Four Corners Acquisition. (*See* Snook, Tr. at 438:12-25.)

21 FVROR is simply another figure from the 2012 Settlement and Decision No. 73183
22 that must necessarily change by the inclusion of the Four Corners Acquisition in rate base.
23 As demonstrated mathematically by APS Witness Snook in his Rebuttal Testimony,
24 FVROR is the result of a calculation involving: (1) Original Cost Rate Base; (2) the
25 Weighted Average Cost of Capital ("WACC"); (3) the "Fair Value Increment" (Fair Value
26 Rate Base – Original Cost Rate Base); and (4) the return allowed (in this case, 1%) on the
27 Fair Value Increment.
28

1 Kalbarczyk and RUCO Witness Mease conceded this point – their proposed FVRORs are
2 less than the WACC found by the 2012 Settlement and Decision No. 73183. (See Mease,
3 Tr. at 573:23-74:12; Kalbarczyk, Tr. at 648:11-49:3 and also Staff Exhibit 20) And the
4 2012 Settlement and Decision No. 73183 determined the Company's WACC every bit as
5 much as if the number 8.33% had appeared in the respective documents. Both the 2012
6 Settlement and Decision No. 73183 specifically find the Company's debt/equity ratio
7 (46.06%/53.94%), its Cost of Equity (10.00 %) and Cost of Debt (6.38%). Paragraphs 5.1
8 and 5.2 of the 2012 Settlement; Decision No. 78183 at Findings of Fact Nos. 37 and 38.
9 WACC is a simple and undisputed mathematical calculation once all the necessary inputs
10 are established. See APS Exhibit 4.

11 In Decision No. 53537 (April 27, 1983) at page 15, the Commission stated:

12 "[t]he beginning point of our inquiry [concerning FVROR] must be the cost
13 of capital. It is difficult to imagine a situation in which a reasonable return
14 on FVRB [Fair Value Rate Base] would yield less than the cost of capital
which comprises that rate base." [Emphasis in original.]

15 The ROO does not address *Arizona Water Company* in its Conclusion on the issue of
16 FVROR. However, Staff's argument that *Chaparral City Water Company* is somehow
17 inconsistent with *Arizona Water Company* is addressed below. Staff's second argument
18 against the viability of *Arizona Water Company* – that it was not the result of a settlement –
19 actually strengthens the precedential value of *Arizona Water Company*.

20 **C. APS's Position on FVROR does not Violate *Chaparral City* but**
21 **Rather is Fully Consistent with the Court's Holding in that**
22 **Case.**

23 As the Commission is well aware, the court in *Chaparral City* rejected the
24 underlying finding of FVROR, not because it was formulaic (many aspects of ratemaking
25 are formulaic such as WACC, the revenue conversion factor, rate adjustment mechanisms,
26 etc.), but because it was a "*superfluous* mathematical exercise" (emphasis supplied) that
27 gave no weight to FVRB. (See *Chaparral City* at 7 – 8 and 28.) The court criticized the
28 Commission for simply taking the OCRB times the WACC and divided it by FVRB. In

1 other words, the Commission had determined FVROR in accordance with the formula
2 described by APS Witness Snook, *except that the Fair Value Increment was given no*
3 *return.*

$$4 \quad \text{FVROR} = \frac{[(\text{WACC} \times \text{Original Cost Rate Base}) + (0\% \times \text{Fair Value Increment})]}{\text{Fair Value Rate Base}}$$

5 (See Rebuttal Testimony of Leland Snook, APS Exhibit No. 5, at 3) And it was because the
6 Commission gave the Fair Value Increment no return that the court deemed the rate
7 treatment of the FVROR to be a “superfluous mathematical exercise.” (*Id.*)

8
9 The Commission’s response to *Chaparral City* in both the Company’s 2009 rate case
10 and its 2012 rate decision was to determine a specified return on the Fair Value Increment.
11 See Decision Nos. 71448 (December 30, 2009) at Exhibit A, Paragraph 4.3, Attachment A;
12 and 73138 at Exhibit A, Paragraph 5.3. Doing so resolved the *Chaparral City* court’s
13 concern by making the Fair Value Increment meaningful.

14 In the ROO, the 1% return on the Fair Value increment agreed to in the 2012
15 Settlement is diminished by (i) giving no incremental weight to the FVRB associated with
16 the Four Corners Acquisition; and, (ii) diluting the return on the Fair Value Increment
17 agreed to in the 2012 Settlement and adopted in Decision No. 73183. A decision that dilutes
18 the return already established in a proceeding for the Fair Value Increment runs afoul of
19 *Chaparral City*. It is only the Company’s suggested FVROR that fully preserves the weight
20 afforded FVRB in Decision No. 73183 and remains consistent with *Chaparral City*.

21 **D. The Facts in the Black Mountain Decision are Distinguishable**
22 **from the Current Proceeding in Several Critical Respects, and**
23 **the Determination of FVROR Using the Same Methodology**
24 **from the Black Mountain Decision Increase the Company’s**
Revenue Requirement Attributable to the Four Corners
Acquisition by Over \$12 Million.

25 At page 33, lines 3 through 6, the ROO also cites Decision No. 71914, which
26 involved UNSE’s acquisition of the Black Mountain Generating Station from an affiliate
27 (“the Black Mountain Decision”) as support for the ROO because the Commission
28

1 determined that a previously determined FVROR of 6.18% should be applied to a new
2 generating plant not previously owned by the utility or included in rate base. Although
3 superficially similar to the situation in this proceeding, there are several critical factual and
4 legal differences between the two proceedings.

5 First, the Black Mountain Generation Unit ("Black Mountain") at issue in the Black
6 Mountain Decision was an entirely new and discreet generating unit. Unlike in the present
7 circumstance, nobody was suggesting that part of Black Mountain earn the utility's WACC
8 and another part earn significantly less than the utility's WACC.

9 Second, Black Mountain was previously the seller in a power purchase agreement
10 with the utility. The PPA provided for a return to the seller equal to the utility's WACC.
11 When the PPA was folded into the utility's cost of service, so was the return. Therefore, the
12 real issue before the Commission in the Black Mountain Decision was whether the utility
13 would be allowed a premium over and above that already-determined cost of service. APS
14 is not requesting any such premium. The Company's proposed FVROR would allow it an
15 opportunity to recover APS's WACC on the Four Corners Acquisition—nothing more.

16 Third, the Commission did not determine FVROR in the Black Mountain Decision
17 by assigning a return value to the Fair Value Increment and then factoring in the resultant
18 product with the WACC to produce a FVROR, as done in this proceeding and the
19 Company's previous rate case. In Black Mountain, by contrast, the Commission took the
20 WACC and removed an inflation factor of 2.1% to produce a FVROR. This methodology
21 mathematically favors utilities having a large Fair Value Increment relative to OCRB, as
22 was the case in the Black Mountain Decision. (See Decision No. 71914 at 51) For example,
23 if the same inflation adjustment methodology had been employed in this proceeding, APS's
24 FVROR would have been 6.23% (8.33% - 2.1%). The resultant increased revenue
25 requirement associated with the Four Corners Acquisition would be over \$78 million. Thus,
26 the Black Mountain Decision is no exception to the position espoused in *Arizona Water*
27
28

1 Company and indeed likely allowed recovery on Black Mountain of more than the utility's
2 WACC.

3
4 **III. CONCLUSION.**

5 APS seeks only to recover the costs of owning and operating that additional portion
6 of Four Corners acquired from SCE as the Four Corners Acquisition. This was what was
7 agreed to in Article X of the Settlement Agreement and approved in Decision No. 73183.
8 Attached as Exhibit A is a Proposed Amendment that would accomplish that objective.

9 RESPECTFULLY SUBMITTED this 15th day of December 2014.

10
11
12 By: Thomas L. Mumaw
13 Thomas L. Mumaw
Melissa M. Krueger

14 Attorneys for Arizona Public Service Company

15 ORIGINAL and thirteen (13) copies
16 of the foregoing filed this 15th day of
December 2014, with:

17 Docket Control
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21 this 15th day of December 2014 to:

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EXHIBIT A

Docket No: E-01345A-11-0224

APS Proposed Amendment #1 Change FVROR and Resulting Revenue Requirement

DELETE Page 30, Line 18 through Page 34, Line 14 and INSERT:

We agree that APS's application and calculation of the FVROR in determining the revenue requirement is consistent with the Settlement Agreement attached to Decision No. 73183. Therefore, the FVROR is hereby modified from 6.09% to 6.14%. This will result in an annual revenue requirement of \$65.44 million, which results in an increase of 2.33% to the base rate portion of customer's bills.

Page 46, Line 19:

DELETE: "\$57.05" & INSERT: "\$65.44"

Page 47, Line 12:

DELETE: "\$57.05" & INSERT: "\$65.44"

Make all conforming changes.